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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

1995

In the Matter of	)	
	)	
Annual Assessment of the Status	)	CS Docket No. 95-61
of Competition in the Market for	)	
the Delivery of Video Programming	)	

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REPLY COMMENTS OF HOME BOX OFFICE

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SUMMARY

The comments filed in response to the Commission's Notice of Inquiry concerning the status of competition to the cable industry paint a healthy picture of the competitive landscape. By and large, the comments indicate that the marketplace forces have created a competitive arena for the delivery of multichannel video programming and that further regulation is unnecessary.

The past year has been characterized by the rapid proliferation of alternative multichannel video programming distributors ("MVPDs"). Most notably, direct broadcast satellite systems, multichannel multipoint distribution systems and local exchange carriers are becoming viable competitors to cable.

The advent of these new distribution technologies has offered video programmers new outlets for their services. As video programmers have every incentive to maximize distribution of their product using these alternative MVPDs, HBO submits that there is no valid reason for retaining the program access rules. To the extent they continue to exist, HBO believes that the program access rules should apply to vertically and non-vertically integrated programmers alike, as vertically integrated providers have no greater incentive to inflict competitive harm than non-vertically integrated providers. Further, the comments offer no support that there is need or cause for the Commission to reconsider whether it is appropriate to award damages in program access cases at this time.

HBO takes exception to the comments filed by Satellite Receivers, Ltd. suggesting that programmer affiliated C-band satellite service packagers, like HBO's C-band retail distributor, HBO Direct, Inc., are placing independent home satellite dish ("HSD") distributors at a competitive disadvantage. The vast majority of C-band HSD users who subscribe to HBO are not served by HBO Direct, and only a scant six percent of HBO's subscriptions are sold through satellite dealers, who receive the rebates about which SRL is presumably complaining. At no time does HBO Direct provide programming to its dealers at less than HBO's cost, as SRL suggests. These facts dispel any notion that program affiliated packagers are engaging in anticompetitive practices.

Finally, HBO reiterates that signal security should be of paramount importance in any action taken by the Commission with regard to the delivery of video programming. Theft is a monumental problem for MVPDs. In order to charge for their services, they must be able to prevent theft of their signals. The Commission should not, therefore, require the retail sale of set-top decoders, which are the very devices used to pirate services.

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Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming	)	CS Docket No. 95-61

To: The Commission

REPLY COMMENTS OF HOME BOX OFFICE

Home Box Office, a Division of Time Warner Entertainment Company, L.P. ("HBO"), by its attorneys, hereby submits its reply to the comments filed in the above-captioned proceeding.[1] By and large, the comments filed regarding the status of competition among multichannel video programming distributors ("MVPDs") are organized around a central theme -- the marketplace, as it has in other telecommunications industries, has created a competitive arena for the delivery of multichannel video programming. Thus, the commenters support the notion that the marketplace, not unnecessary regulation, should be the prime force in creating and maintaining the competitive landscape. As is amply demonstrated by the commenters, alternative MVPDs are providing considerable competition to cable at this time.

1 Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, CS Docket No. 95-6, FCC 95-186 (released May 24, 1995) ("Notice" or "NOI").

The number and strength of alternative MVPDs will continue to grow in the future, thereby lowering prices and increasing viewing options for the public.

I. COMMENTERS HAVE PAINTED A HEALTHY PICTURE OF THE COMPETITIVE LANDSCAPE

A. The Number of Viable Alternative MVPDs Has Increased

The competitive landscape in video programming delivery over the past year was characterized by the rapid proliferation of alternative MVPDs. Direct broadcast satellite ("DBS") systems have debuted to strong demand and more DBS systems will soon emerge. Multichannel multipoint distribution ("MMDS") or wireless cable systems are becoming increasingly competitive thanks to an influx of capital, the Commission's deregulatory efforts, and the advent of digital technology. Moreover, local exchange carriers are beginning to test their own video distribution systems and are poised to become, perhaps, cable's most formidable competitor to date. Satellite master antenna television ("SMATV") subscribers have grown to an estimated 1.09 million, and, with the promise of additional channels and digital technology, the broadcast industry will enter a new competitive era.

It is particularly telling that the statistics provided by trade associations representing two of the major competitors to cable, the Wireless Cable Association International, Inc. ("WCAI") and the Satellite Broadcasting and Communications Association of America ("SBCA") lend support to the conclusion that there now exist numerous viable competitors to cable. As HBO suggested in its initial comments, and as WCAI confirms, there can be no doubt "that wireless cable is providing consumers in many markets with a competitive alternative to their wired cable service providers, and soon will be expanding across the country." WCAI Comments at 2. WCAI indicates that, since the Commission compiled its last report to Congress, wireless cable has increased its number of subscribers by 150%, and expects subscribership to increase from 800,000 to 4 million by the year 2000. Id. at 2-3. As WCAI states, then, there is "every indication that wireless cable is emerging as a competitive check on the pricing and other practices of the cable monopoly." Id. at 28.

Similarly, the information garnered from the direct-to-home ("DTH") industry segment indicates that competition to cable from satellite services has expanded this year and is growing rapidly. SBCA estimates that the total number of DTH subscribers (C-band, medium-power Ku-band and DBS) now amounts to approximately 3 million households, as compared to 1.8 million in 1993, and that the future for satellite services is bright. In 1994, C-band technology hit a new high of more than 640,000 new system shipments and over 720,000 new subscribers authorized to receive encrypted programming. SBCA Comments at 8. DIRECTV, Inc. ("DIRECTV") asserts that the launch of the first DBS satellites "inaugurated a new era in the provision of video programming" and validates the conclusion that DBS "has advanced as a potential long-term viable competitor to cable." DIRECTV Comments at 2. DIRECTV which, in conjunction with USSB, offered the only high-power DBS service available over the past year, estimates that by the end of 1995 it will have 1.5 million subscribers and that by the end of the century it will deliver programming to 10 million households. Id. The National Cable Television Association ("NCTA") indicates that cable companies are already feeling the effects of DBS as it attracts a wide range of customers, including those in areas served by cable. NCTA Comments at 4.

In addition, telephone companies pose an enormous competitive challenge to cable companies. While some of the commenters in this proceeding, notably those with plans to offer video dialtone ("VDT") services, (e.g., The Video Dialtone Association, GTE, Bell Atlantic, NYNEX, BellSouth), would label cable as "dominant," their comments are must be considered in the context of their motivations -- they are literally "chomping at the bit" to deliver video services, and would have the Commission and Congress remove all barriers to their entry while maintaining a regulatory leash on cable operators. Given the political landscape, it seems apparent that legislative and legal measures will soon unleash the telephone industry, with its capital, market power and ubiquitous access to customers, and allow them to aggressively compete with cable television operators in the delivery of video programming.

B. As Long as the Program Access Rules Remain in Effect, They Should Be Extended to Non-Vertically Integrated Programmers

HBO believes that the program access rules are unnecessary, but that, as long as they exist, they should be extended to apply to vertically and non-vertically integrated programmers alike.[2] Interestingly, as the National Cable Television Cooperative, Inc. ("NCTC") points out, prior to the passage of the 1992 Cable Act, the larger portion of the program providers who denied access to NCTC were vertically integrated, but not with cable operators. Instead, they were owned in common with broadcast companies and movie studios and, therefore, not covered by the program access rule under the 1992 Cable Act.

While the filing of program access complaints with the Commission has been noticeably light, to the extent the commenters in this proceeding support their retention, their complaints center on non-vertically integrated programmers. As a practical matter, vertically integrated providers have no greater incentive to inflict competitive harm than non-vertically integrated providers, as demonstrated in an article published by Professor David Waterman of Indiana University in the Federal Communications Law Journal and included by WCAI with

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[2] As pointed out by other commenters, the Commission currently lacks statutory authority to extend its program access rules to non-vertically integrated programers.

their comments in this proceeding.[3] Although HBO takes exception to some of the assertions made in the Waterman article, HBO concurs with Professor Waterman's conclusion that "one cannot make a reasonable case for separate treatment of vertically integrated and nonintegrated firms."

One may also conclude from Professor Waterman's article that the incentive for vertically-integrated programmers to discriminate, if it exists at all, certainly does not extend beyond the franchise areas of their own cable systems. By regulating the activities of vertically-integrated programmers outside the franchise areas of their own cable systems, the Commission has extended the program access rules to areas where there is no evidence that regulation is justified - indeed, where there is not even a theoretical basis for believing discrimination will occur.

Finally, with regard to program access, a number of commenters have argued that the Commission should award damages to private parties where program access rule violations are found to have occurred. The Commission has recently examined the issue of its authority to order appropriate remedies for

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3 David Waterman, *Vertical Integration and Program Access in the Cable Television Industry*, 47 Fed Com L.J. 511 (1995). In the course of his article, Professor Waterman cites certain statistics which include purported differences between the wholesale rates charged by HBO to small vs. large cable operators, and to cable operators vs. SMATV and MMDS operators. While HBO's pricing practices incorporate rate differentials to reflect factors permitted by the Cable Act of 1992 and the program access rules (such as volume and performance), the rates quoted in Professor Waterman's article grossly overstate the magnitude of those differentials.

program access rule violations and concluded that the award of damages is not necessary at this time.[4] HBO submits that the current processes are working, and that the comments offer no evidence of a need or cause for the Commission to reconsider the issue of damages at this time.

C. Independent HSD Distributors Are Not Competitively Disadvantaged

As HBO and others indicated in their initial comments, the C-Band home satellite dish ("HSD") market is thriving. As SBCA describes, sales of programming to consumers are undertaken by approximately 30 national program packagers. These business entities contract with various program services to act as a central agent in marketing program packages to consumers. C-Band HSD households subscribe to programming service directly through the programmers, through independent program packagers which act as distributors for the programmers, through satellite retail dealers who act as representatives for the programmers and distributors, or through some combination of these sources.

HBO currently has affiliations with more than twenty distributors who package and offer HBO services via C-Band. HBO also has its own C-Band HSD retail distributor, HBO Direct, Inc. ("HBO Direct") which sells program packages to consumers directly through an "800" number and through its dealer

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4 Memorandum Opinion and Order on Reconsideration of First Report and Order in MM Docket 92-265, 10 FCC Rcd 1902, 1910-11 (1994),

representatives, who sell HBO Direct programming packages to consumers when they purchase satellite equipment.

One commenter in this proceeding, Satellite Receivers Ltd. ("SRL"), an HSD distributor, argues that programmer-affiliated packagers, like HBO Direct, that distribute the programming services of their corporate affiliate, are placing independent HSD distributors, like SRL, who are not corporate affiliates of any programming services, at a competitive disadvantage, SRL argues that "programmer affiliated packagers are able to subsidize the price of their packages through the margins built into their own services," resulting in pricing which the non-program affiliated distributor cannot match. SRL Comments at 4-5. HBO takes exception to these comments, and a simple examination of the facts militates against any such conclusion.

First of all, fewer than twenty percent of C-Band HSD users who subscribe to HBO are served by HBO Direct; the vast majority (more than 80%) of HBO's C-Band subscribers are served by HSD distributors unaffiliated with HBO. More than fifty percent of those C-Band subscribers served by HSD distributors are served by independent distributors who are not affiliated with <u>any</u> programmer; indeed seven of the top ten HBO C-band distributors are not affiliated with any programmer. These facts alone dispel any notion that program affiliated packagers are threatening the viability of non-program affiliated distributors.

SRL complains that "programmer packagers are selling their packages at retail and to dealers at prices which are lower than the wholesale costs incurred by the independent packagers." SRL Comments at 2-3. HBO suspects that the real target of SRL's complaint is the practice of some programmer affiliated packagers to offer a rebate to dealers as an incentive for these dealers to aggressively market particular program packages when they sell equipment. HBO Direct, for example, offers its dealer representatives rebates when they sell programming packages. Such rebates are utilized by many HSD distributors, including independent distributors not affiliated with any programming service. HBO Direct's practice of offering rebates to its dealer representatives is a legitimate promotional device to encourage dealers to promote the HBO Direct program packages and, in fact, is no different from the practice engaged in by many independent distributors, who discount equipment as well as programming. <u>At no time</u> does HBO Direct provide programming to its dealer affiliates at less than HBO's cost, as SRL intimates.

The facts vitiate any suggestion that HBO is subsidizing the price of the packages sold through its C-Band sales arm in order to place independent distributors at a competitive disadvantage. Moreover, only a scant six percent of HBO's total C-Band sales are sold by dealers. It strains credibility to suggest, as SRL does, that rebates to dealers pose a threat to distributors.

II. SIGNAL SECURITY SHOULD BE OF PARAMOUNT IMPORTANCE IN ANY ACTION TAKEN BY THE COMMISSION WITH REGARD TO THE DELIVERY OF VIDEO PROGRAMMING

Several commenters in this proceeding graphically illustrate that whatever action the Commission may take with regard to the market for the delivery of video programming, in making its decisions the Commission consistently must consider the potential impact on system security. As General Instrument Corporation ("GI") aptly states, "meaningful competition among MVPDs is premised upon the comparable ability of each MVPD to charge end users for their services. In order to charge for services, video providers must be able to prevent the theft of their signals." GI Comments at 3.

In its initial comments, HBO, while recognizing that there may be some benefit to allowing set-top decoders to be sold at retail, stated that when weighed against the very significant downside to such retail sales, these benefits are of no consequence. The very real dangers of creating a retail set-top market, most significantly the threat to system security, are detailed by a number of commenters, including GI and NCTA. The staggering information concerning theft of services offered by these commenters amply supports HBO's conclusion that the Commission simply cannot require the retail sale of the very devices used to pirate services.

NCTA confirms that the cable industry today is battling a multi-billion dollar theft of service problem. According to NCTA, most cable piracy occurs through the modification of cable descramblers illegally obtained from cable system suppliers. GI indicates that "one out of every ten basic service customers and one out of every ten premium service customers illegally obtain their cable services." Id. Further, GI and others cite numerous instances of armed robberies where increasingly brazen pirates staged raids on cable warehouses to obtain converter boxes to sell in the illegal market. See, e.g., GI Comments at 7.

According to GI, piracy in the DBS, HSD, MMDS and SMATV industries is equally problematic. The SBCA reports spending two-thirds of its budget on preventing theft because "otherwise there would be no satellite industry today." Id. at 8. All video service providers will need to be able to control access to their services from in-home terminal devices in order to compete effectively. The Commission should not, therefore, take any steps to promote the development of a retail market for set-top boxes. Further, HBO concurs with GI's assessment that "without [constant attention to system security], the Commission cannot possibly weigh the true impact of decisions relating to government standard setting, the conversion to digital, the retail sale of equipment, or cable operator use of scrambling technologies." Id. at 9.

III. THE MARKETPLACE, NOT THE COMMISSION, SHOULD SET TECHNICAL STANDARDS

The "hands off" regulatory approach touted by most of the commenters in this proceeding should extend to the area of government standards setting, particularly with respect to digital television. As the comments make clear, every video provider, both wired and wireless, is poised to benefit from technological advancements and some providers with historically limited capacity will gain competitive strength. As NCTA points out, digital compression techniques have already influenced competition in the video marketplace, as DBS is flourishing as a result of digital technology making it feasible to multiply the number of available DBS channels to over 100. NCTA Comments at 20. Similarly, other alternative MVPDs are likely to "leverage efficiencies generated by digital compression to maximize service offerings and lower the cost of bundled services." GI Comments at 17.

The comments evidence steadfast opposition to any effort by the Commission to manage technological change through government mandated technical standards setting. As GI suggests, "marketplace forces are simply a better, more efficient arbiter for setting technical standards." Id. at 12. HBO fully concurs with GI's assessment that "when the government permits the market to operate unfettered, innovators innovate, competition flourishes, consumer choices increase, and prices plummet." Id. at 14.

HBO agrees with the suggestion that the most likely barrier to the deployment of digital compression technology would be the governmental establishment of digital standards at this time. As GI points out and NCTA reiterates, mandating standards would only stifle innovation. The video distribution media should be free to experiment with various approaches and to test consumer acceptance -- allowing the marketplace to create standards, where necessary, and to ensure that the public has access to a variety of distribution media.

IV. CONCLUSION

In light of the comments submitted in response to the Notice, HBO submits that the Commission should report to Congress that the state of competition in the video programming distribution industry is healthy and increasingly vigorous. Both the Commission and Congress are on the record as favoring less regulation, eliminating unnecessary current regulations, and letting competitive marketplaces function. HBO believes that this regulatory philosophy should be applied to the market for the delivery of video programming.

Respectfully submitted,

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July 28, 1995

CERTIFICATE OF SERVICE

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